

AVOIDING BAD MOVES — LESSONS FROM U-HAUL

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Anita Stork
Cortlin Lannin

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This summer, the Federal Trade Commission signaled it would continue to aggressively pursue so-called “invitation to collude” cases.

On July 20, 2010, the FTC commissioners unanimously approved a final consent agreement with U-Haul International Inc. and its parent company over allegations that the truck rental company issued public and private invitations to its major competitors, Budget Truck Rental LLC and Penske Truck Leasing Co. LP, to collude on higher prices for one-way truck rentals. See *In the Matter of U-Haul Int’l Inc. and AMERCO*, FTC File No. 081-0157.\

Several facts underlying the U-Haul case suggest the FTC is, if anything, growing less tolerant of invitations to collude.

Because the line separating a legitimate business discussion from an illegal invitation to collude can be murky and often context-specific, the U-Haul case provides valuable lessons on how to avoid risk.

First, employees should avoid written and verbal proposals to talk with competitors about competitively sensitive topics, regardless of how seriously those proposals are meant.

Second, even junior employees should avoid direct conversations and contacts with competitors about sensitive issues.

Finally, executives speaking on earnings calls or in other public forums should pick their words with exceeding care and avoid even oblique comments about price and output, particularly in the context of what competitors are doing.

Background

An “invitation to collude” occurs when one firm makes overtures to a competitor that it is ready and willing to coordinate on the price or output of a good (or on some other dimension of competition), and there is no legitimate business justification to otherwise explain the offer. The firm can issue these invitations through private or public channels.

A long line of FTC cases has established that such invitations can violate Section 5 of the Federal Trade Commission Act as an unfair method of competition, even where there is no evidence that an actual agreement on price or output was reached and no evidence of actual anti-competitive effects.

Under the FTC’s reasoning, the mere invitation risks anti-competitive harm to consumers. This bears reiteration: A firm may violate Section 5 through invitations to collude even when

the target of those invitations declines the offer. The cold shoulder, in other words, is no defense.

Invitations to collude may also violate Section 2 of the Sherman Act as acts of attempted monopolization. See *United States v. American Airlines Inc.*, 743 F.2d 1114 (5th Cir. 1984).

But in U-Haul, as in most invitation-to-collude cases, the FTC proceeded under Section 5 of the FTC Act, which prohibits unfair methods of competition and has a broader reach than the Sherman Act.

Indeed, three FTC commissioners, including the chairman, issued a statement accompanying the U-Haul consent agreement noting that invitations to collude “are the quintessential example of the kind of conduct that should be — and has been — challenged” as a violation of Section 5.

This statement speaks to the FTC’s interest in applying Section 5 broadly and represents an unmistakable warning that the agency will continue to pursue aggressively invitation to collude cases.

The U-Haul Case

The U-Haul matter arose against a backdrop of apparently healthy competition in the one-way truck rental market. U-Haul and its closest competitor, Budget, together controlled almost 70 percent of the market for one-way truck rentals.

However, vigorous competition between the two restrained U-Haul’s ability to raise prices. U-Haul CEO Edward Shoen, apparently convinced that prevailing rates were unprofitable and unsustainable in the long run, allegedly developed a strategy by which U-Haul invited Budget to collude on price increases.

Those invitations were to be delivered through both private and public channels.

The FTC complaint first detailed a scheme in which regional U-Haul managers were to reach out privately to their counterparts at Budget (or Penske) and invite price cooperation.

In one internal memo from 2006, Shoen instructed U-Haul’s regional managers to raise prices above Budget’s rate (or, in some cases, to first undercut the Budget rate, to “teach” Budget its lower rate could not stand, and then adopt the higher rate).

The managers were then instructed to “let Budget know” about the higher rate with the object of getting Budget to go higher too. A later memo, also authored by Shoen, offered a “script” for managers to use when contacting their counterpart: “Try ‘Are you tired of renting 500 miles for \$149 and \$28 commission? Then, tell your Budget/Penske rep that U-Haul is up and they should be too.’”

The memo noted that U-Haul dealers “know how to have this conversation and who to call to have it ...”

The FTC alleged that at least one U-Haul manager in the Tampa, Fla., area followed Shoen's instructions to invite collusion. In late 2006, this manager raised one-way rates and contacted his regional Budget counterpart to "let them know," but Budget did not immediately react.

The manager reported this to Shoen, who encouraged the manager to keep in contact with Budget before dropping back to the lower rate.

The manager contacted Budget again almost a year later, after which Budget matched U-Haul's higher rates in the Tampa area.

Next, in late 2007, Shoen determined to lead a nationwide increase in one-way rental rates. To effect this new scheme, Shoen instructed all regional managers to raise prices and hold them there.

Then, Shoen allegedly issued a thinly veiled invitation to collude on at least one public conference call about U-Haul's earnings. Shoen was aware that Budget representatives would listen to these calls.

In a February 2008 call to discuss U-Haul's third-quarter earnings, Shoen repeatedly emphasized that U-Haul was demonstrating "price leadership" in competitive markets and "trying to force prices."

Shoen complained that Budget's pricing strategy was to monolithically discount off U-Haul's price, which produced economic "turbulence that results in no economic gain for the group, in fact probably economic loss."

Having argued that Budget's pricing strategy was irrational, Shoen then noted that U-Haul managers had been instructed to "hold the line at a little higher" in order for prices to "stabilize."

Shoen insinuated that he could tolerate a 3- to 5-percent price differential with Budget.

However, Shoen claimed that U-Haul would respond if its market share started to erode — in other words, if Budget refused to increase prices to correspond with U-Haul's higher rates.

Based on these facts, the FTC alleged that U-Haul had invited Budget "to join with U-Haul in a collusive scheme to raise prices for one-way truck rentals."

The complaint does not allege that U-Haul and Budget reached an agreement to raise prices or that U-Haul's actions actually harmed competition, nor must it.

As the three commissioners succinctly wrote in their statement, "invitations to collude do not require proof of an agreement; nor do they require proof of an anti-competitive effect."

Lessons

The broad factual allegations underlying the U-Haul case are familiar. Both government prosecutors and the FTC have previously targeted executives who made private invitations to collude with competitors.

And the FTC's interest in communications surrounding corporate earnings dates at least to 2004, when the agency filed a lawsuit to block a proposed merger between Arch Coal Inc. and a competitor.

Even though the Arch Coal complaint sought to enjoin a merger, the FTC included allegations that Arch Coal was signaling competitors through public statements in a press release announcing quarterly earnings in which the CEO praised output discipline.

Ultimately, the FTC's efforts to block the merger were unsuccessful. See *FTC v. Arch Coal Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004) (declining to enjoin merger).

In 2006, the FTC brought its first successful invitation to collude action predicated exclusively on an executive's comments during an earnings conference call. See *In the Matter of Valassis Comm'n Inc.*, 2006 WL 1367833 (F.T.C. 2006).

Against this backdrop, several important facts about the U-Haul case stand out and, along with the commissioners' statement, suggest the FTC will maintain a hard line toward collusive overtures.

First, the FTC pointed to U-Haul internal memos as evidence of Shoen's conscious decision to try to induce Budget to raise prices.

The FTC found compelling evidence in these internal memos, particularly when combined with actual communications between U-Haul and Budget personnel on the subject of pricing.

Second, the complaint contains no allegation that Shoen himself, or other senior U-Haul executives, actually contacted their counterparts at Budget or Penske to invite price cooperation. Past FTC complaints, however, have focused on senior executives' actions.

For example, in one case the president and general manager of the implicated company traveled to meet directly with representatives of a bothersome new competitor and, after informing them their prices were "ridiculously low," threatened a price war. In *Matter of Precision Moulding Co. Inc.*, 122 F.T.C. 104, 105-06 (1996).

Similarly, in the *Stone Container Corp. linerboard* case, the FTC alleged that "senior officers of Stone Container contacted their counterparts" at competing firms to inform them of output reductions. In *Matter of Stone Container Corp.*, 125 F.T.C. 853, 854 (1998).

But the U-Haul case underscores that the FTC will scrutinize the actions of lower-level managers as well as those of senior managers.

While in this case the lower level employees were alleged to have been acting at the direction of senior managers, it is not clear that the FTC would view the involvement of senior management as a necessary condition to liability. This could be a particularly challenging concern for large organizations or those with decentralized organizational structures where junior employees are subject to less oversight.

Finally, the language Shoen used on an earnings conference call to allegedly invite collusion was slightly more oblique than in *Valassis*. See *Valassis*, 2006 WL at 1367833.

There, the CEO of Valassis Communications Inc., allegedly aware that his sole competitor would be listening, described with striking specificity during an earnings conference call the new pricing strategy his firm would adopt to end a ruinous price war between the two companies.

The CEO noted that Valassis would abandon its goal of reaching a 50 percent market share and then described the exact price floor it would observe when bidding for customers who had contracts expiring with News America Marketing Properties LLP, the competitor.

For customers who shared their business between the two companies, Valassis would “price [its] share at whatever price is necessary to retain [its] share of the business.”

Finally, the CEO promised to monitor News America’s response to this blatant overture and threatened to “go back to our previous strategy” if News America continued to chase market share.

On the whole, the call laid out an unmistakable and detailed invitation for the two companies to divvy up the market and raise prices as a result.

Shoen’s comments on the U-Haul call, while less specific, were still provocative. He stressed that vigorous price competition was hurting U-Haul and its competitors, that higher prices would help everyone and that U-Haul would at least temporarily maintain higher rates in an effort to “stabilize” the market.

He gave a hint of what “stabilization” looked like by suggesting a 3- to 5-percent price differential was acceptable to his company.

Unlike his Vallasis counterpart, Shoen did not quote specific market share or price targets (although the market-specific nature of the truck rental business may explain why).

Conclusions

The U-Haul case serves to warn company employees to tread ever more cautiously in both their private and public comments with or about competitors.

First, employees should not write internal memos or other documents that mention or propose talks with competitors about sensitive topics, even in a speculative way.

Second, company executives must be vigilant in discouraging direct contacts or communications between lower-level employees and their counterparts at competing firms.

The Analysis of Agreement Containing Consent Order to Aid Public Comment the FTC issued in the U-Haul case expressly notes that “less egregious conduct may result in Section 5 liability” and that it is “not essential that the commission find repeated misconduct attributable to senior executives ...”

If the activities of even junior employees can create risk of enterprisewide liability, those activities warrant close scrutiny.

Finally, comments made during earnings conference calls and in other public forums are not immune from risk. Company executives should avoid discussing their firm's specific prices and other sensitive competitive information, especially in the context of what competitors are or might be doing.

And even more oblique comments about maintaining "price leadership," for example, and offering hints about what price the firm hopes to lead, could risk liability under the U-Haul precedent if they are perceived as part of an effort to signal competitors.

These risks are likely heightened for firms operating in markets with oligopolistic characteristics. Given the enforcement actions earlier in Vallasis and now in U-Haul, the FTC may view itself as having delivered a proverbial shot across the bow that puts companies on notice.

Company executives should take care to avoid becoming the next example.